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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 923

SAGER GLOVE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

LLEWELLYN A. LUCE
937 Munsey Building
Washington, D. C.
Counsel for Petitioner

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The petitioner, by its counsel, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered on December 17, 1962. (App., infra, p. 28, Document 3, Certified Record), affirming the decision of the Tax Court of the United States entered on December 21, 1961 (App. infra, p. 44, R 57).

OPINIONS BELOW

The Findings of Fact and Opinion of the Tax Court of the United States are reported in 36 T. C. 1173 and may be found in the Appendix, infra, p. 29-44 (R. 42-57).

The opinion of the Court of Appeals, promulgated December 17, 1962 (App., infra, p. 23, Document 4, Certified Record) is reported at 311 F.(2d), p. 210.

JURISDICTION

The judgment of the Court of Appeals was made and entered on December 17, 1962 (App., infra, p. 28, Document 3, Certified Record). The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1).

QUESTIONS PRESENTED

1. Whether the true measure of damages is to be determined by ascertaining how much less valuable a taxpayer's business is after the business is injured or destroyed by the wrongful acts of the defendants in an action for damages.

2. Whether damages received in partial recompense for losses sustained by injuries to a taxpayer's business or property constitute a nontaxable return of capital in partial recompense for the losses sustained, capital items in reduction of loss, rather than gain or profit taxable as ordinary income.

3. Whether loss of anticipated profits is only an evidential factor in determining actual loss or an independent basis of recovery.

4. Whether damages received must be considered in the "light of the claim" from which they were realized and reflected in the petition or pleading filed in the action brought for damages.

5. Whether, if the fund received by petitioner as damages was in excess of the value of the properties destroyed and the value of good will and capital investment lost, the gain was taxable as capital gain at capital gain rates or as ordinary income.

6. Whether the Court of Appeals erred in affirming the decision of the Tax Court of the United States.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SECTION 22. GROSS INCOME.

(a) General Definition. "Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SECTION 117. CAPITAL GAINS AND LOSSES.

(c) Alternative Taxes.

(1) Corporations. If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207 (a) (1) or (3), 421 and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

(A) A partial tax shall first be computed upon the net incom reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted.

(B) There shall then be ascertained an amount equal to 25 per centum of such excess, except that in the case of any taxable year beginning after March 31, 1951, and before April 1, 1954, there shall be ascertained an amount equal to 26 per centum of such excess.

(C) The total tax shall be the partial tax computed under subparagraph (A) plus the amount computed under subparagraph (B).

SECTION 117. (j)

(2). General Rule. If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets * * *.

STATEMENT OF THE CASE

The petitioner is a corporation organized under the laws of the State of Illinois during September of 1921, as Sager Mercantile Company. On April 1, 1929 its name was changed to Sager Glove Corporation. During the year 1951 and at all times pertinent hereto, petitioner maintained its office and principal place of business in Chicago, Illinois and filed its Federal Income tax return for the taxable year 1951, here involved, with the District Director of Internal Revenue for the First District of Illinois. (App., infra, p. 30, R. 43).

Since 1926, petitioner has been engaged in the business of manufacturing and selling fire safety material and equipment for the protection of workers in industry. Beginning in 1931, it also engaged in the development, manufacture, and sale of industrial safety goggles to protect the eyes of workers in hazardous and semi-hazardous occupations. (App., infra, p. 30, R. 43).

During the year 1940, petitioner filed in the District Court of the United States for the Northern District of Illinois, Eastern Division, a suit, Civil Action 2221, under the Federal antitrust laws against Bausch & Lomb Optical Company, a corporation, American Optical Company, an association, and American Optical Company, a corporation, alleging that petitioner's business and property had been injured and damaged by the wrongful acts of the defendants. (App., infra, p. 31, R. 44).

On or about February 15, 1944, petitioner filed an amended complaint against the aforementioned defendants alleging that its business in the industrial goggles field had been destroyed completely by the defendants. (App., infra, p. 31, R. 44); that petitioner had been eliminated as a competitor in the production of industrial safety goggles; and that defendants had caused petitioner irreparable loss, damage, and injury to its business. (App., infra, p. 32, R. 45).

Petitioner further alleged in its amended complaint that it had lost its monies spent in research, equipment, molds, dies, and machinery in developing and promoting goggles; that it had lost large sums in fighting destructive tactics by the defendants; that it had lost valuable contracts; that it had lost monies from the liquidation of its stock of lenses and that it had lost profits and anticipated profits. (App., infra, p. 32, R. 46).

The case subsequently came on for trial in the United States District Court at Chicago and on August 10, 1951, the jury found a verdict for the plaintiff assessing damages against the defendants in the sum of $325,000. (App., infra, p. 36, R. 49). The Court entered its judgment for the petitioner in the amount of $975,000 (treble damages, being three times the sum of the jury's verdict) together with costs and charges. (App., infra, p. 36, R. 49). Thereafter the Court entered its order determin-

ing an allowance to petitioner for attorneys fees in the amount of $132,000 and costs in the amount of $1,833. (App., infra, p. 36, R. 49).

On December 14, 1951, the Court granted the defendants' motion for a new trial. (App., infra, p. 36, R. 49).

Thereafter, the parties (petitioner and the defendants in the case) settled the suit out of court for $478,142 to be paid petitioner by the defendants. (App., infra, p. 37, R. 50-51).

On or about December 19, 1951, petitioner received from the defendants the sum of $478,142 of which $132,000 was for attorneys' fees (App., infra, p. 38, R. 59-51). Petitioner paid its attorneys $151,971 during December of 1951. (App., infra, p. 38, R. 51).

Petitioner and the Commissioner of Internal Revenue agreed that the $132,000 received by petitioner for attorneys' fees was a deductible item by petitioner. (App., infra, p. 39, R. 52). This left the remainder of the damages $346,142, received by petitioner, in controversy as to its taxability. (App., infra, p. 39, R. 52).

The Commissioner determined a deficiency in petitioner's Federal income taxes for the taxable year 1951 in the amount of $167,735.33. (App., infra, p. 29, R. 42) on the theory that the $346,142 in damages constituted ordinary income taxable to petitioner for that year. (App., infra, p. 29, R. 42). Petitioner contended that this sum of $346,142 constituted a nontaxable return of capital. (App., infra, p. 29, R. 43), in partial compensation for losses sustained by petitioner as a result of its goggles business being destroyed and its entire business injured generally by the tortious and wrongful acts of the defendants in the action for damages.

The petitioner appealed to the Tax Court of the United States and the case came on for hearing in Chicago, Illinois, on April 18, 1960. (App. infra, p. 29, R. 3).

The Commissioner contended before the Tax Court that the entire amount of $346,142 received by petitioner pursuant to the settlement in the antitrust suit constituted ordinary taxable income under Section 22(a) of the 1939 Code as compensation for the loss of anticipated profits.

Petitioner contended before the Tax Court that its goggles business had been destroyed and that the gravamen of its action in the antitrust suit was the injury and damage to its business and property by the tortious and wrongful actions and tactics by the defendants in that suit and that the complaint therein had specifically alleged that the petitioner's goggles business had been destroyed by these defendants. Petitioner contended that the capital it had invested in the goggles business and the goodwill attaching thereto had been destroyed, injured and lost. (App., infra, p. 39-40, R. 53).

It was the position of petitioner that the damages received were only a partial recompense for the losses sustained which amounted to at least $550,000 and that damages received in partial recompense for injuries to a taxpayer's business constitute a nontaxable return of capital in partial compensation for losses sustained. (App., infra, p. 42, R. 53).

The petitioner urged that as a matter of law a taxpayer cannot be charged with gain or profit on account of damages received in partial compensation for the injury to and destruction of its business and property. (App., infra, p. 40, R. 53). This would be equivalent to treating a loss as a gain. It would substitute fiction for reality. Such damages are capital items in reduction of loss rather than income.

Petitioner also pointed out that loss of profits is only an evidential factor in determining actual loss and not an independant basis of recovery.

The Tax Court's own Findings of Fact show that there was a proper basis for the application of the foregoing legal principles upon which petitioner relied before the Tax Court.

The Tax Court's Findings of Fact showed that:

The petitioner's claim and petition for damages alleged that the petitioner's goggle business had been destroyed and the petitioner's business damaged and injured by the wrongful acts of the defendants. (App., infra, p. 31, R. 45).

The District Court Judge in the antitrust suit instructed the jury that it should determine the amount of the damages if it found that the plaintiff company was damaged and excluded from the industrial goggles business by the wrongful acts of the defendants. (App., infra, p. 35, R. 48).

The jury found damages for the petitioner company in the amount of $325,000. (App., infra, p. 36, R. 49).

Samuel N. Sager, petitioner's president and treasurer testified that petitioner lost goodwill and patronage in the goggles business having a value of $500,000 and sums invested in research, equipment and advertising in the goggles business having a value of $50,000. He testified that the amount received in the settlement by petitioner was not sufficient to compensate petitioner for the injury and damage to its business and property. (App., infra, p. 42, R. 55-56).

The petitioner's president and treasurer testified as follows as to the losses sustained by petitioner as a result of the tactics of the defendants in the damage suit action. (R., p. 7 and 8):

"* * * We lost the complete good will of all the customers we had in the goggle business by the cut off of the supply of lenses to us by Baush & Lomb. * * *"

"* * * We lost the research—the value of research that went into the creation of all these things plus the value of two years of effort in the field based on research to determine the contour of the cups so that they would fit on the average human face. All of this amounted to a very large sum."

"* * * I succeeded in obtaining the greatest business in the history of the goggle business in May of 1935—that was the General Motors contract.

The Court: To supply goggles?

The Witness: To supply goggles and lenses and replacement parts.

The Court: All right. Well, go ahead.

The Witness: Now, your Honor, when that happened, then American Optical Company threatened Baush & Lomb with a war on this type of material, and Baush & Lomb ceased the sale of lenses to us and we had to ask to be released under the obligation of the contract under General Motors. * * *"

He testified that the value of the customer patronage and good will of the customers in the goggles business which petitioner lost on account of the tactics of the defendants in the damage suit amounted to $500,000 and the value of petitioner's capital invested in machinery, research, equipment, and tools amounted to $50,000. (R. 19, 20, 21).

Nevertheless the Tax Court held that the entire amount of the damages received by petitioner in 1951 constituted ordinary income rather than a nontaxable return of capital in partial recompense for the damage and injury to petitioner's business and property.

The Tax Court ignored, by-passed, or lightly touched upon the points of law raised by petitioner. It concluded that evidence of lost profits constituted an independent

basis of recovery rather than an evidential factor in determining actual loss.

The Tax Court sustained the Commissioner in determining a deficiency in Federal income tax against petitioner for the taxable year 1951 in the amount of $164,060.10. (App., infra, p. 44, R. 57). Petitioner appealed to the United States Court of Appeals for the Seventh Circuit from the decision of the Tax Court. (R. 58-63).

The Court of Appeals on December 17, 1962 promulgated its opinion affirming the decision of the Tax Court. (App., infra, p. 23, Document 4, Certified Record) and entered judgment for the Commissioner of Internal Revenue. (App., infra, p. 28, Document 3, Certified Record).

REASONS FOR GRANTING THE WRIT

The opinion and decision of the Court of Appeals, affirming the decision of the Tax Court, involves substantial questions of Federal tax law. In deciding the case, the Court below has disregarded and failed to follow or adhere to important principles of Federal tax law which have been established by this Court and the United States Courts of Appeal as follows:

1. The true measure of damages is to be determined by ascertaining how much less valuable a taxpayer's business is after the business is injured or destroyed by the wrongful acts of the defendants in an action for damages. Doyle v. Mitchell Bros. Co., 247 U. S. 179, 184, 185, 38 S. Ct. 467, 469. Lucas v. American Code Co., 280 U. S. 445, 50 S. Ct. 202. Burnet v. Logan, 283 U. S. 404, 51 S. Ct. 650. Yates v. Whyel Coal and Coke Co. v. Hartman, 111 F. 96, 99 (C.C.A. 8). Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner of Internal Revenue, 59 F. (2d) 913 (C.C.A. 6).

In Burnet v. Logan, supra, this Court, citing its decision in Doyle v. Mitchell Bros. Co. supra, declared:

> "* * * Prior to 1921, all receipts from the sale of her shares amounted to less than their value on March 1, 1913. She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture.
>
> "'In order to determine whether there has been gain or loss, and the amount of the gain if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration.' Doyle v. Mitchell Bros. Co., 247 U.S. 179, 184, 185, 38 S. Ct. 467, 469, 62 L. Ed. 1054. Revenue Act 1916, Sec. 2, 39 Stat. 757, 758; Revenue Act 1918, c. 18, 40 Stat. 1057. * * *

* * * *

As stated in *Lucas* v. *American Code Co.*, 280 U.S. 445, 449, the law is concerned with only realized losses and realized gains and "In order to determine whether there has been gain or loss, and the amount of the gain if any, we must withdraw from the gross proceeds an amount sufficient to restore *the capital value* that existed at the commencement of the period under consideration." *Doyle* v. *Mitchell Bros. Co.*, 247 U.S. 179, 185." (Italics ours)

In Farmers' & Merchants' Bank of Catlettsburg, Ky. v. Commissioner of Internal Revenue, supra, the Court concluded:

> "* * * We think that the gravamen of petitioner's action against the Reserve Bank was the injury inflicted to its banking business generally, and that the true measure of damages was compensation to be determined by ascertaining how much less valuable its business was by reason of the wrongful acts of the Reserve Bank. See Yates v. Whyel Coal & Coke Co. v. Hartman, 111 F. 96, 99 (C.C.A. 8). * * *"

2. Damages received in partial recompense for losses sustained by injuries to a taxpayer's business or property

constitute a nontaxable return of capital in partial recompense for the losses sustained. Such damages are capital items in reduction of loss rather than income. Boehm v. Commissioner, 146 F. (2d) 553 (C.C.A. 2). Strother v. Commissioner, 55 F. (2d) 626, 633 (C.C.A. 4) reversing in part Bankers Pocahontas Coal Co., 18 B.T.A. 901, with which the Strother appeal was consolidated, affirmed by this Court without discussion of the point involving the unwarranted determination of gain from the damages received, 277 U. S. 308. Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner of Internal Revenue, supra. Central R. Co. of New Jersey v. Commissioner 79 F. (2d) 697 (C.C.A. 3).

In *Boehm* v. *Commissioner*, 146 F. (2d) 553 (C.A. 2), supra, the Court held:

> "Where complaint in stockholders' derivative action charged that directors acted illegally in destroying corporation's assets and stockholder had never received any deduction from gross income in any taxable year because of the loss of the stock, the sum recovered by stockholder in settlement of the action constituted a capital item in reduction of a loss rather than income, and hence such amount was not taxable. Revenue Act 1936, Sec. 23(e), 26 U.S.C.A. Int. Revenue Code, Sec. 23(e)."

The Court said:

* * * *

> "In holding that the taxpayer had not proved that the payment was not income we think the court was in error. The complaint in the Graham suit charged that the defendant directors had acted illegally and in a manner destructive of the corporation and the rights of its stockholders, and to its and their great damage. Clearly whatever the petitioner received in settlement was paid her as a stockholder and represented damages for destruction of the value of her stock caused by the allegedly illegal acts of the defendants. Since her stock had become worthless be-

> fore 1937 and since she had never received any deduction from her gross income in any taxable year by reason of the loss of her investment in the stock, the sum she recovered in the settlement must be regarded as a capital item in reduction of her loss rather than as income." * * *"

* * * *

Strother v. Commissioner, 55 F. (2d) 626, 633, supra, involved damages received pursuant to the settlement of an action for unlawful trespass. The trespasser had removed coal from the taxpayer's property. The amount received under the compromise settlement had no relation to the coal extracted from the land as the amount thereof could not be determined. The Court upheld the taxpayer's contention that the Commissioner was unwarranted in determining a taxable gain to the extent of the amount received under the compromise of the action for damages.

In Central R. Co. of New Jersey v. Commissioner, 79 F. (2d) 697 (C.A. 3), supra, the taxpayer corporation received an amount in settlement of a suit for damages resulting from business operations adverse to the taxpayer corporation's interests. The suit was brought in equity on the theory that the defendants had conspired to defraud the taxpayer.

In that case, the Third Circuit Court of Appeals cited with approval and followed the decision of the Sixth Circuit in Farmers' & Merchants" Bank of Catlettsburg, Ky. v. Commissioner 59 F. (2d) 913, supra. The Court held that the amount recovered by the taxpayer, in the action for damages, did not constitute taxable income.

3. Loss of profits is only an evidential factor in determining actual loss and not an independent basis of recovery. Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner of Internal Revenue, supra.

4. Damages received must be considered in the "light of the claim" from which they were realized and reflected in

the petition or pleading filed in the action brought for damages. Central R. Co. of New Jersey v. Commissioner, supra. Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner, supra.

The Court below did not apply the legal principles set forth above to this case and it failed with one exception to discuss or even mention the decisions cited above which established these principles.

The Court of Appeals did not follow the decisions of this Court and of the United States Courts of Appeal establishing the proper method for the true measurement of damages. It did not adhere to the decisions of the higher Courts holding that damages received in partial recompense for losses sustained by injuries to a taxpayer's business and property are a reduction of loss rather than income and constitute a nontaxable return of capital.

The Court below did discuss Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner, supra, in an effort to distinguish that case from the one at bar on the ground that it did not involve loss of profits or damages for loss of profits. With all respect for the learned Court of Appeals we think that it must have overlooked the concluding paragraph of the opinion of the Sixth Circuit in deciding the Farmers' and Merchants' Bank case, supra, holding that loss of profits is only an evidential factor in determining loss and declaring:

> "* * * Injury to its business of course means injury to its financial standing, credit, reputation, good will, capital, and other possible elements. Profits were one of the chief indications of the worth of the business; but the usual earnings before the injury, as compared with those afterward, were only an evidential factor in determining actual loss and not an independent basis for recovery. We think that, if petitioner's case had proceeded to a verdict, the law would not have awarded to it what it might have expected to gain but only that which it had actually

lost. We are not justified in reading an element into the compromise which was not therein distinctly recognized in fact and would not have been recognized in law. *We think therefore that there is no logical basis upon which petitioner could be charged with gain.* See Strother v. Com'r, 55 F. (2d) 626, 683 (C.C.A. 4). *One may be recompensed for an injury but it is a rare case in which one should have a profit out of it.*

"The order of the Board of Tax Appeals is reversed." (Italics supplied)

The Court below did discuss the point that "the fund involved must be considered in the light of the claim from which it was realized" and reflected in the petition filed in the action for damages. However, the Court of Appeals did not mention that the Tax Court found as a fact that the amended claim of petitioner in the antitrust suit alleged that the defendants by their unlawful acts had injured the plaintiff's business and property and destroyed its goggles business. (App., infra, p. 31, R. 45). In its opinion the Court of Appeals did not consider the damages petitioner received in the light of the petitioner's goggle business being destroyed. We think that to treat the partial compensation here received for the destruction of a portion of the taxpayer's business, as a taxable gain, would be the equivalent of treating a loss as a gain. It would substitute fiction for reality.

Moreover, under the decisions and opinions of the Courts as cited and discussed herein, above, the fund received by the petitioner was not taxable as ordinary income. It was a capital item received under the claim of the petitioner in the antitrust suit that its goggle business had been destroyed. If the amount of the fund received was in excess of the value of the goggle business of petitioner, the value of the good will lost, and the amount of capital invested in such business, then such excess in value was taxable as capital gain at capital gain rates and not as ordinary income as held by the Court below.

In the courts below, the Commissioner relied upon the case of *Raytheon Production Corp.* v. *Commissioner*, 144 F. (2d) 420 (C.C.A. 1st, 1944) for the proposition that the entire gain in the case at bar was ordinary income, and taxable as such. Assuming that there was a gain, the *Raytheon* case is inapplicable. The *Raytheon* case was decided under the Revenue Act of 1936. Under said Act, capital gains were given lower rate tax treatment only when realized by individuals (Sections 111, 112(a) and 117); as to corporations, such gains were taxable as ordinary income.

In the Internal Revenue Code of 1939, provision was made for taxation of corporate capital gains at capital rates. (Sec. 117(c); present Sec. 120 (a) of the 1954 Code). Section 117(j)(2) of the 1939 Code made gains from involuntary conversion of property used in the trade or business "as a result of destruction in whole or in part", capital gains, taxable at capital gains rates. (Sec. 117 (j)(2) of the 1939 Act is the present Sec. 1231 of the 1954 Code.)

It seems clear that the petitioner suffered an involuntary conversion of its corporate assets, through destruction of the same as a result of the antitrust conspiracy. The antitrust violations rendered valueless all of the petitioner's machinery and equipment for making goggles; destroyed the valuable General Motors requirements contract, and other contracts owned by petitioner; and destroyed the industrial goggles branch of petitioner's business.

Under these circumstances, we think that, if there was any gain, such gain was a capital gain, taxable at capital gains rates, and not ordinary income.

In *Jones* vs *Corbyn*, 186 F. (2d) 450, C. A. 10th, 1950), the Corbyns, insurance agents, had a general insurance agency contract with Occidental Ins. Co., under

which they were exclusive agents of the Insurance Company, in Oklahoma, for sale of policies. This contract was to continue until the death of the last agent.

In 1944, difficulties arose. The agents brought suit against the insurance company to determine the validity of the contract, joining three separate causes of action for damages.

Pending trial, the parties settled the suit. The agents resigned as agents, and turned over all business under the contract to the Insurance Company; they also released all claims for damages. The Insurance Company paid the agents the sum of $45,000.

The agents returned said $45,000. as a *long term capital gain.* The Commissioner asserted that it was *ordinary income.*

The Commissioner urged that the agency contract was a mere employment, and was not a capital asset. The Court of Appeals held that it was a capital asset, speaking in part as follows (p. 452):

> "The contract or franchise had at all times substantial value. It was capable of producing income for its own. It was enforceable at law and could be bought and sold.
>
> * * * *
>
> "Property may be tangible or intangible such as a franchise or good will.
>
> * * * *
>
> " 'Property' within the tax laws should not be given a narrow or technical meaning. We think that what the taxpayers owned in this case was a capital asset."

The Court further held that the sum received was for the value of the contract which was surrendered and should be regarded as a capital gain, and not as a prospective profit. The Court spoke in part as follows (p. 453) in pointing out that the fund must:

" * * * be considered in the light of the source from which it was realized. Swastika Oil & Gas Co. v. Commissioner of Internal Revenue, supra; Farmers' and Merchants' Bank v. Commissioner of Internal Revenue, 6 Cir., 59 F. 2d 912. The amount of the settlement in this case was not based upon damages. It was based upon the value of the exclusive business franchise. The fact that the suit ended in a compromise settlement does not change the nature of the recovery. The nature of the basic claim from which the amount is received is the determining factor. *Raytheon Production Corp.* v. Commissioner of Internal Revenue, supra. The amount recovered here was based on the value of the contract and the business and was not damages or prospective profits. * * * "

In the case at bar, the goggles business of the petitioner was destroyed by the wrongful actions of the defendants in the damage suit. There was an involuntary conversion, a destruction, of a branch of the taxpayer's business. Consequently under the specific provisions of Section 117 (j) of the 1939 Internal Revenue Code, any gain derived from compensation received by the taxpayer for the destruction of a branch of its business is taxable as capital gain at capital gain rates and not as ordinary income as held by the Court of Appeals in affirming the decision of the Tax Court.

2. The decision of the Court below (affirming the opinion of the Tax Court) is in conflict with a number of decisions of other United States Courts of Appeal.

It is in conflict with the decisions of the Second Circuit in Boehm v. Commissioner, supra, 146 F. (2d) 553 and of the Fourth Circuit in Strother v. Commissioner, supra, 55 F. (2d) 626, 633, holding that damages received in partial recompense for injuries to a taxpayer's business or property constitute capital items in reduction of loss, a non-taxable return of capital, rather than taxable ordinary income. Strother v. Commissioner, supra, in turn relied upon the decision of this Court in Burnet v. Logan, 283 U. S. 404, 51 S. Ct. 650, supra.

In Farmers' & Merchants' Bank of Catlettsburg, Ky. v. Commissioner, 59 F. (2d) 913, supra, the United States Court of Appeals for the Sixth Circuit held:

That damages received in partial recompense for injuries to a taxpayer's business or property constitute a non-taxable return of capital and are capital items in reduction of loss rather than income,

That the true measure of damages is to be determined by ascertaining how much less valuable a taxpayer's business is after the business is injured or destroyed by the wrongful acts of the defendants in the action for damages, and

That loss of profits is only an evidential factor in determining actual loss and not an independent basis of recovery.

The decision of the Court of Appeals herein is contrary to and in direct conflict with the decision of the Sixth Circuit in the Farmers' and Merchants' Bank case.

The decision of the Court below is also in conflict with the decision of United States Court of Appeals for the Third Circuit in Central R. Co. of New Jersey v. Commissioner, 79 F. (2d) 697 (C.C.A. 3). In that case the taxpayer corporation received an amount in settlement of a suit for damages for wrongful operations injurious to the taxpayer corporation's business. In deciding the case, the Third Circuit cited with approval the decision of the Sixth Circuit in Farmers' and Merchants' Bank of Catlettsburg, Ky. v. Commissioner, supra, and held that the amount received by the corporation did not constitute taxable income.

The decision of the Seventh Circuit Court of Appeals in the case at bar is inconsistent with and in conflict with the decision of the Sixth Circuit Court of Appeals in *Durkee* v. *Commissioner of Internal Revenue*, 162 Fed. (2d) 184, June 4, 1947. In the Durkee case, Durkee was

an electrical contractor. Thirty firms and corporations, in the same business, fixed prices; controlled bidding; prevented bidding by Durkee, and induced builders not to deal with Durkee. Durkee had an established business. Durkee brought suit against said thirty firms, under the antitrust law of Ohio, alleging (App., p. 185):

"18. By reason of the foregoing acts and conduct of the defendants, the good will of plaintiff's business has been destroyed and he has been deprived of an income therefrom for a period of approximately ten years last past of the approximate value of one hundred fifty thousand dollars.

"19. Wherefore, plaintiff prays for judgment against the defendants, and each of them, in a sum fixed pursuant to Section 6397 of the General Code of Ohio at twofold the amount of plaintiff's damages, to-wit, in the sum of three hundred thousand dollars, and for his costs of suit."

This suit was settled for $25,000.

The Commissioner, and the Tax Court, held that said sum was for loss of profits, and was taxable as ordinary income. The Sixth Circuit Court of Appeals reversed, speaking in part as follows. (Op., pp. 186, 187):

"The gravamen of the amended petition is that the good will of the petitioner's business, which had been built up over a period of years, had been destroyed by the acts of the defendants, which caused him a loss of $150,000. This damage is computed through the loss of income. No claim is made for lost profits. As was the case in Farmers' & Merchants" Bank v. Commissioner, supra, the allegations as to profits both before and after the acts complained of "were only an evidential factor in determining actual loss and not an independent basis for recovery."

* * *

"* * * The Commissioner held all of it to be taxable income. It is contended that it was the duty of the petitioner to prove either that the entire recovery was nontaxable income or the proper allocation between taxable income and nontaxable income, and that failure to meet this

burden requires that the Commissioner's ruling be upheld. Hord v. Commissioner, 6 Cir., 143 F.2d 73; H. Liebes & Company v. Commissioner, supra; Buck v. Commissioner, 9 Cir., 83 F.2d 786. Such is the rule where the ruling is not arbitrary or excessive and has support in the evidence. Cherokee Motor Coach Company v. Commissioner, 6 Cir., 135 F. 2d 840, 841; Sellmayer Packing Co. v. Commissioner, 4 Cir., 146 F. 2d 707, 714. But where it is apparent from the record that the Commissioner's determination is arbitrary and excessive, the taxpayer is not required to establish the correct amount that lawfully might be charged against him, and he is not required to pay a tax that he obviously does not owe. In proceedings before the Tax Court, as distinguished from suits for refund in the District Court, it is sufficient to show that the Commissioner's determination is invalid. Upon such a showing the case should be remanded to the Tax Court for further hearings on the point involved. Helvering v. Taylor, 293 U.S. 507, 55 S. Ct. 287, 79 L.Ed. 623; Worcester County Trust Company v. Commissioner, 1 Cir., 134 F.2d 578, 580; Stock Yards National Bank v. Commissioner, 8 Cir., 153 F.2d 708, 712; Piper v. Commissioner, 5 T.C. 1104, 1111. Obviously, a large portion, if not practically all, of the $25,000 received was in settlement of the lawsuit, and under our view of the case was not taxable as a matter of law. The Tax Court should hold further hearings in order to determine the proper allocation between the taxable and nontaxable portions of the amount received in settlement."

* * *

The case at bar and the *Durkee* case involve the same point. The antitrust suit by Sager Glove Corporation was brought pursuant to the Sherman Anti-Trust Law, which provides, in part, that any person "injured in his business or property", by reason of violations of the Anti-Trust Laws, may sue therefor. Durkee's suit was brought pursuant to Section 1331.08 of the Ohio Revised Code, which provided that ". . . the person injured in his business or property", by violations of the Ohio Anti-Trust Law, may sue therefor.

In addition, the decision in the case at bar is inconsistent with and in conflict with the case of *Jones* v. *Corbyn*,

186 F.(2d) 450, supra, decided by the Tenth Circuit Court of Appeals and discussed hereinabove with reference to the question whether capital gains rates are applicable to such gain as might exist herein. The *Jones* case recognizes gain from the disposition of corporate capital assets as capital gain, to which capital gain rates should be applied. In the case at bar, the Seventh Circuit Court of Appeals disregarded the fact that Sager Glove Corporation suffered an involuntary conversion of its capital assets: (1) its investment in tools and equipment to make goggles; (2) its goggles contracts, including the valuable General Motors requirements contract, and (3) the entire goggles division of its business. This treatment puts the meaning and application of Sec. 117(j)(2) of the 1939 Code (now, Sec. 1231 of the 1954 Code) in doubt. This conflict should, in the interest of certainty and the uniform administration of the taxing laws, be resolved by this Honorable Court.

It is respectfully submitted that the issues herein now before this Court constitute important questions of Federal tax law which should be finally settled by this Court.

CONCLUSION

For the reasons set forth above, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

LLEWELLYN A. LUCE
937 Munsey Building
Washington, D. C.

Counsel for Petitioner

APPENDIX

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 13776 SEPTEMBER TERM, 1962
SEPTEMBER SESSION, 1962

SAGER GLOVE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of the Tax Court of the United States.

December 17, 1962

Before SCHNACKENBERG, KILEY and SWYGERT, *Circuit Judges.*

SWYGERT, *Circuit Judge.* This is an appeal from a decision of the Tax Court, 36 T.C. 1173 (1961), sustaining a deficiency assessment against petitioner in the amount of $167,735.33 for the taxable year 1951.

The facts are set out at length in the Tax Court opinion and will not be repeated here. In summary, petitioner instituted suit under the federal antitrust laws against certain optical companies. The amended complaint in that suit listed nine different elements of damages including three recitals of loss of profits stemming from the wrongful acts alleged. The jury returned a verdict for peti-

tioner in the amount of $325,000, and the court awarded triple this amount together with costs and charges, and attorneys' fees of $132,000. A motion for a new trial was granted, but the parties compromised their differences out of court—the petitioner receiving $478,142 in settlement, of which $132,000 was designated as attorneys' fees. No mention was made as to the proper allocation of the remainder. In its tax return for 1951 the petitioner reported one-third of $478,142, or $159,380, as ordinary income; it reported the balance, $318,762, as nontaxable income with the explanation that it represented punitive damages awarded in the antitrust suit.

In 1955, the United States Supreme Court ruled that the punitive two-thirds portion of a treble-damage antitrust recovery constituted taxable income under Section 22(a) of the Internal Revenue Code of 1939. *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426. This ruling destroyed the basis for petitioner's claims in its 1951 return. In the instant Tax Court proceeding the petitioner took the position that, except for the $132,000 attorneys' fees included in the settlement, the remainder, or $346,142, consists of nontaxable return of capital.

The Commissioner concluded and the Tax Court agreed that the $346,142 remaining after deducting attorneys' fees constitutes reimbursement for lost profits. If this determination as to the nature of the recovery is sound, the Commissioner's conclusion that it is taxable income is correct. *Carter's Estate* v. *Commissioner*, 298 F. 2d 192 (8th Cir. 1962), cert. denied, 370 U. S. 910 (1962). The Commissioner's determination has the support of a presumption of correctness and the taxpayer has the burden of proving it to be wrong. *Welch* v. *Helvering*, 290 U. S. 111 (1933). A mere allegation of damages to "good will" does not meet that burden. *Carter's Estate* v. *Commissioner*, *supra*.

The Tax Court considered all the evidence presented to it. It noted particularly the fact that the settlement

amount, after deducting attorneys' fees, was within $10.00 of the amount that Sager, petitioner's president, had claimed in the antitrust proceeding to be lost profits for the period January 1, 1936, through December 31, 1943.[1] It also considered Sager's testimony in the instant case that the petitioner had invested some $50,000 in the destroyed business and that it valued the patronage and goodwill lost at $500,000. The Commissioner was not required to accept these estimates, made in a self-serving context, as conclusive of the issue. Furthermore, he was not required to give undue weight to the many allegations in the antitrust complaint regarding injury to business and goodwill when the evidence supports rather pointedly a reimbursement-for-lost-profits determination.

In order to carry its burden of proof, petitioner must do more than merely claim alternative designations for what it recovered—it must prove a designation so that some orderly tax treatment may be accorded it. The evi-

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[1] Excerpts from testimony of Mr. Samuel N. Sager on direct examination in the antitrust suit of *Sager Glove Corporation* v. *Bausch & Lomb Optical Co. and American Optical Company*, Civil Action No. 2221.

Q. What is your estimated total gross profits on the goggles and lenses?

A. The total amount?

Q. The total gross.

A. $531,338.

Q. What was the total selling and administrative expense that you took off of that?

A. $185,206.

* * * *

Q. Did you deduct that from your estimated total of gross for the years 1936 to 1943?

A. Yes.

Q. Did that give you the estimated totals of net profit for the years 1936 through 1943?

A. Yes.

Q. What is that figure?

A. $346,132.

Q. For the eight year period?

A. Yes, sir.

dence adduced by petitioner is wanting in this respect. A conclusion made by taxpayer that the settlement payment was for destroyed capital or that goodwill was worth $500,000, or that $50,000 was invested in the business, is not that degree of proof necessary to overcome the presumptive correctness of the Commissioner's determination as a matter of law. Particularly is this so in view of the substantial evidence that supports the Commissioner's finding that only lost profits were accounted for in the settlement.

Petitioner relies heavily on the decision in *Farmers' & Merchants Bank* v. *Commissioner*, 59 F. 2d 912 (6th Cir. 1932), reversing 20 B.T.A. 622. In that case the petitioner had compromised a suit against the Federal Reserve Bank of Cleveland and had listed the settlement amount, after deducting expenses, as nontaxable income. The Court of Appeals for the Sixth Circuit reversed the decision of the Board of Tax Appeals that had held the settlement proceeds to be taxable as reimbursement for lost earnings. In reversing the Court said:

> "The fund involved must be considered in the light of the claim from which it was realized and which is reflected in the petition filed in its action against the Reserve Bank. We find nothing therein to indicate, with the certainty required in the statement of a cause of action, that petitioner sought reparation for profits which petitioner's misconduct prevented it from earning in 1925. Charles E. Rous, petitioner's cashier, testified before the Board that the loss of such earnings *could not be definitely determined and this probably furnishes the explanation for the failure definitely to demand it.*" (Emphasis supplied.)

In its amended complaint in the antitrust proceeding, petitioner claimed damages for loss of profits in recitals (g), (h), and (i). As already mentioned, testimony of petitioner's president in that action showed lost profits of $346,132 for the eight-year period in question. This sum

plus attorneys' fees closely approximated the settlement amount. Obviously these facts clearly distinguish this case from that cited by petitioner.

We are satisfied that the Tax Court's determination is based on substantial evidence. The Tax Court applied correct principles of tax law and therefore its decision is affirmed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit.

JUDGMENT

UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Monday, *December 17, 1962*

Before

Hon. *Elmer J. Schnackenberg, Circuit Judge*
Hon. *Roger J. Kiley, Circuit Judge*
Hon. *Luther M. Swygert, Circuit Judge*

No. 13776

SAGER GLOVE CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW OF A DECISION OF THE TAX COURT OF THE UNITED STATES

THIS CAUSE came on to be heard on the transcript of the record from the *Tax Court of the United States*, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the *Tax Court of the United States* entered in this cause on *December 21, 1961*, be, and the same is hereby, AFFIRMED, in accordance with the opinion of this Court filed this day.

36 T. C. No. 119.

TAX COURT OF THE UNITED STATES.

Sager Glove Corporation, *Petitioner* v. Commissioner of Internal Revenue, *Respondent*.

Docket No. 75057 36 Filed September 29, 1961.

Petitioner instituted suit under the Federal antitrust laws against certain optical companies, charging loss of profits and injury to its business and property during the years 1936 to 1943, inclusive. The jury awarded damages of $325,000 and the court entered judgment of treble that amount together with costs and charges, and attorneys' fees of $132,000. Thereafter the court ordered a new trial, but the suit was settled by the parties out of court, the petitioner receiving in settlement an amount of $478,142, of which $132,000 was designated as attorneys' fees. Neither the release nor any other evidence establishes the extent, if any, that the remainder of $346,142 represented a recovery of lost capital. *Held*, that the petitioner has failed to meet his burden of proving error in respondent's determination that the entire amount received in settlement constituted ordinary income under section 22(a) of the Internal Revenue Code of 1939.

Llewellyn A. Luce, Esquire, for petitioner.

David H. Nelson, Esquire, Seymour I. Sherman, Esquire, for respondent.

ATKINS, *Judge*: The respondent determined a deficiency in income tax in the amount of $167,735.33 for the taxable year 1951.

The issue is whether the full amount of $478,142 received by petitioner in 1951 in settlement of an antitrust suit is taxable as ordinary income as determined by respondent or whether $346,142 thereof constitutes nontaxable return of capital as contended by petitioner.

Adjustment will be made under Rule 50 in accordance with agreement between the parties as to other issues.

FINDINGS OF FACT.

Some of the facts are stipulated, and the stipulations, including the stipulated exhibits, are incorporated herein by this reference.

Petitioner is a corporation organized under the laws of the State of Illinois in September 1921 as the Sager Mercantile Company. On April 1, 1929, its name was changed to the Sager Glove Corporation. At all times pertinent hereto it maintained its principal office and place of business in Chicago, Illinois. Its corporate income tax return for the calendar year 1951 was filed with the director of internal revenue for the first district of Illinois.

During the year 1951, Samuel N. Sager owned 67 percent and his wife Clara M. Sager owned 33 percent of the outstanding stock of petitioner. Samuel N. Sager was the president and treasurer of petitioner and in active control of its business affairs. Clara Sager was its secretary.

Since 1926 petitioner has been engaged in the business of manufacturing and selling safety material, equipment, clothing and protective apparel for the protection of the entire body of the worker in industry, including leather and asbestos gloves, mittens, hand pads, and wool and fireproof garments. Since 1931 it has also engaged in the development, manufacture, and sale of industrial safety goggles to protect the eyes of workers engaged in hazardous and semi-hazardous occupations.

On or about October 14, 1940, the petitioner filed in the District Court of the United States for the Northern District of Illinois, Eastern Division, pursuant to section 15 title 15, U. S. C. A., a complaint under the antitrust laws against Bausch & Lomb Optical Company, a corporation,

American Optical Company, an association, and American Optical Company, a corporation, alleging that its business and property were damaged by the acts of the defendants. On or about February 15, 1944, it filed an amended complaint in the suit setting forth three counts. The first count alleged violations of the Act of Congress of July 2, 1890 (title 15, U. S. C. A., sections 1-7), commonly known as the Sherman Act. The second count alleged violations of the Act of Congress of October 15, 1914, commonly known as the Clayton Act. The third count alleged violations of the Act of Congress of July 19, 1936, commonly known as the Robinson-Patman Act. Each count states, in pertinent part, as follows:

> * * * on October 16, 1935, the defendant, Bausch & Lomb, notified the plaintiff by its communication that it would not sell any of its merchandise to the plaintiff, and would not accept any further orders from it. Thereafter said defendant refused to sell any more lenses to the plaintiff except that it filled the existing orders. Because of this shutting off of its only available source of supply of lenses plaintiff was forced to cancel its contract with General Motors Corporation, losing thereby many thousands of dollars in profits; it was forced to stop soliciting; refused orders and lost many of the customers which it had developed during the preceding years and was destroyed completely as a competitor in the industrial goggle field. * * *
>
> For the purpose of monopolizing the trade, and to eliminate the plaintiff as a competitor, the defendant, Bausch & Lomb, set up the Kimball Safety Products Company at Cleveland, Ohio in the middle of the year 1937, and the defendant, American Optical Company, acquired the interest of the Safety Equipment Service Company at Cleveland, Ohio, to compete with the plaintiff in the general safety equipment field, and as an outlet for its industrial lenses. From then on to this day the defendant, Bausch & Lomb, has used the Kimball Safety Products Company, and the defendant, American Optical Company, has used the Safety

Equipment Service Company for the purpose of ultimately driving the plaintiff out of the safety clothing business through destructive price-cutting tactics. By means of the wide contact with industrial users of safety equipment developed by it through the Kimball Safety Products Company, the defendant, Bausch & Lomb, endeavored to destroy plaintiff's business, in order to gain for itself and for the Kimball Safety Products Company the more lucrative industrial goggle business. * * *

* * * *

The aim and purpose of the defendants is to monopolize for themselves and their own agencies and distributors the manufacture, sale and distribution of industrial safety lenses and goggles, and especially to drive out, through their control of the only source of supply of lenses used in industrial goggles, all independent manufacturers of such goggles who refuse to maintain the prices fixed by them, and by such means and as a result of such conspiracy, combination and monopoly, the said defendants have attempted, and have succeeded, to destroy a part of plaintiff's business, and have eliminated him as a competitor in the production of industrial safety goggles in the United States.

* * * *

The conspiracy, combination and monopoly hereinbefore described is a continuing one and defendants intend to carry it out and will continue to do so unless enjoined by this Court. The unlawful restraints, acts, methods and practices pursuant thereto are continuing daily and are daily causing injury to plaintiff's business and property; plaintiff has suffered, is suffering and will continue to suffer immediate great and irreparable loss, damage and injury to its business and property by reason thereof, unless the defendants are enjoined by this Court.

The damages to plaintiff to date include among other things:

(a) sums spent in research, equipment, molds, dies, machinery, salaries, commission, drawing accounts, advertising and in developing the

manufacture, sale and distribution of goggle cups and frames and in promoting the marketing of the goggles;

(b) large sums in extra expense in fighting the destructive competitive tactics of the American Optical Company and Bausch & Lomb through the Kimball Safety Products Company and the Safety Equipment Service Company in the general safety equipment field;

(c) loss of other valuable and profitable contracts and orders when Bausch & Lomb refused to sell any more lenses;

(d) payment of excessive and unreasonable prices for lenses purchased from Bausch & Lomb;

(e) loss realized on the liquidation of the excessive stock of lenses forced upon plaintiff in 1934 and 1935;

(f) loss of the just fruits of plaintiff's labor, industry and effort;

(g) loss of profits on being forced to cancel the contracts to supply the goggle requirements of General Motors Corporation;

(h) loss of regular and anticipated profits from the sale of industrial safety goggles which plaintiff would reasonably have made but for the unlawful acts of defendants as aforesaid, including profits which plaintiff might reasonably have made, after defendants had unlawfully eliminated it as a competitor;

(i) loss of profits due to the necessity of meeting the cut-throat price competition of Kimball Safety Products Company and Safety Equipment Service Company operated and controlled by the defendants, Bausch & Lomb and American Optical Company in the general safety equipment field.

In the complaint the petitioner did not set forth the specific amount of damage suffered for which judgment

was requested, the prayer for relief in regard to damages being as follows:

> That judgment as provided by law be granted to it against the defendants, and each of them for all damages and injuries as aforesaid, and to be sustained, by reason of said conspiracy, combination and monopoly, and unlawful restraints, acts, methods and practices pursuant thereto, as hereinbefore described; that such damages be made threefold; that the plaintiff recover the costs of this suit, including a reasonable attorney's fee, all in accordance with the statute in such case made and provided.

On November 14, 1944, the District Court entered a judgment dismissing petitioner's complaint. Petitioner appealed to the United States Court of Appeals for the Seventh Circuit from the order of dismissal, and on June 9, 1945, the Court of Appeals entered a judgment reversing the judgment of the District Court insofar as it dismissed the first count of the complaint, but otherwise affirming the judgment of the District Court. Thereafter trial was had in the District Court. At such trial Sager testified that the estimated profits which the petitioner, but for the acts of the defendants, would have earned from the sales of goggles and lenses over the period 1936 through 1943, were $346,132, that this was arrived at by a computation using a percentage of the gross amount of sales of petitioner's safety clothing business and that the amount of damages requested was based upon such estimated profits. His computation of the estimanted profits was introduced in evidence in that case. At such trial Sager also testified that the petitioner purchased various equipment and tools for the goggles business and named four companies, General Motors Corporation, Chrysler Corporation, E. H. Dockson Company, and General Rubber Goods Company, with which petitioner had contracts to supply goggles or lenses.

The District Court judge instructed the jury in part as follows:

* * * The first disputed issue is the allegation or claim of the plaintiff that a conspiracy existed in 1935 between the defendants American Optical Company and Bausch & Lomb, to violate the Sherman Act, namely, to monopolize and restrain interstate trade and commerce by fixing the prices of industrial goggles and lenses.

The second disputed issue is the allegation of the plaintiff that there was an overt act done pursuant to the alleged conspiracy to plaintiff's damage, that is, that it was deprived of a supply of lenses for industrial goggles as a result of the alleged conspiracy, and that the deprivation damaged it in its business or property.

And the third issue is one that you would reach only if you should find in the affirmative as to the two preceding issues or claims of the plaintiff. The third issue is the amount, if any, that the plaintiff has been damaged as a result of an alleged act done pursuant to the alleged conspiracy; that is, you are to determine the amount of damages the plaintiff company suffered in the event you should find that the conspiracy which I have mentioned existed, and if you should further find that the plaintiff company was damaged as a result of an act done pursuant to a violation of the Anti-Trust Laws.

* * * *

If you find that the conspiracy as charged in the complaint was entered into between the defendants and that the plaintiff was excluded from the industrial goggles business as a result thereof, then it will become your duty to ascertain what, if any, damages plaintiff sustained as a direct and proximate result thereof. While the statute under which plaintiff is suing provides for a judgment in which the damages are trebled or three times the actual damage, it is not your responsibility to determine the amount of the judgment. You are simply called upon to find from the evidence what, if any, are the actual damages to the plaintiff. In this connection you may consider only those damages, if any, which proximately resulted from the wrongful acts, if any, of the defendants complained of. Speculative or uncertain

> damages are not recoverable. Damages must be such as are shown by a preponderance or greater weight of the evidence to be logically and legally inferable from the facts proved. Damages are not rendered speculative or uncertain, however, because they cannot be established with absolute exactness. It is sufficient if a reasonable basis for computation is afforded by the evidence.[1]

On August 10, 1951, the jury found the defendants Bausch & Lomb Optical Company, a corporation, and the American Optical Company, an association, guilty and assessed damages against the defendants in the amount of $325,000. On the same date, the court entered its judgment for the plaintiff in the amount of $975,000 (being 3 times the sum of the jury's verdict), together with costs and charges. Thereafter the District Court entered its order determining an allowance to petitioner for attorneys' fees in the amount of $132,000, and for costs in the amount of $1,833.

On December 14, 1951, the District Court entered an order denying motion of the defendants for a summary judgment and for judgment notwithstanding the verdict, but granting their motion for a new trial. However, a new trial was not had. Instead, the suit was settled by the parties out of court. On December 19, 1951, the petitioner as plaintiff in that cause, by its president Samuel N. Sager, signed a general release which provided in part as follows:

> Whereas, upon the trial of said cause, plaintiff claimed damages for the period commencing January

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[1] The District Court judge also instructed the jury to disregard, in determining whether plaintiff is entitled to recover, the allegation in the amended complaint that the defendants used Safety Products Company and Safety Equipment Service Company for the purpose of ultimately driving the plaintiff out of the safety clothing business through destructive price-cutting tactics, since no evidence had been adduced to support such allegation.

1, 1936 through December 31, 1943, in the amount of $346,142.00; and

Whereas, the court in said proceeding fixed the reasonable attorneys' fees of plaintiff in the sum of $132,000; and

Whereas, a new trial has just been ordered in the said cause; and

Whereas, the parties to said cause have agreed to settle their differences; and

Whereas, the defendants have denied any liability to plaintiff but are desirous of avoiding the expense of a new trial and possible appeal and further litigation and unfavorable publicity, and plaintiff is willing to accept the sum of $478,142.00 in full settlement, satisfaction and discharge of any and all claims, actions, damages, or demands (without limitation to the claims, actions, damages, and demands set forth in the above mentioned cause), * * *

Now, Therefore, in consideration of the sum of $478,142.00, in hand paid to the plaintiff by the defendants, * * * The Sager Glove Corporation does * * * hereby release and forever discharge the Bausch & Lomb Optical Company and American Optical Company, * * * of and from any and all manner of actions, causes of action and suits in law or in equity, judgments, claims and demands, which plaintiff, * * * now have, had, or may have had against the defendants, * * * and from all damages now sustained or which may hereafter be sustained by the plaintiff, for and by reason of or growing out of, or which may hereafter grow out of, any matter or thing whatsoever from the beginning of time up to the day of the date hereof, * * *

* * * *

It is understood and agreed by the plaintiff that this release is given and settlement herein made in compromise of doubtful and disputed claims, and that neither the acceptance of this release, nor the payment of the consideration aforesaid therefor shall be construed as an admission of liability on the part of the defendants, their subsidiaries, affiliates, offi-

> cers, directors, trustees, representatives, agents, employees, servants, successors or assigns; it is further understood and agreed by the plaintiff that said defendants expressly deny liability as to all the matters and things hereby released, and that the foregoing terms of this release are contractual, and not mere recitals.

Samuel N. Sager, although he signed the release as president of the petitioner, did not participate in the settlement negotiations, these being conducted by the attorneys in the case.

On December 19, 1951, the District Court entered an order of dismissal of the civil action with prejudice, pursuant to stipulation of the parties. On or about December 19, 1951, the petitioner received payment from Bausch & Lomb Optical Company and American Optical Company of the full amount of $478,142 as set forth in the general release.

In December 1951, the petitioner paid to its attorneys in the antitrust suit the sum of $151,971.

On its income tax return for the taxable year 1951 petitioner reported as ordinary income the amount of $159,380, or about one-third of the total settlement, as "Judgment award—Anti-Trust Suit—Federal Court." The balance of the settlement received, $318,762, was reported by petitioner on its return as nontaxable income with the explanation "Punitive damages awarded in Federal District Court for Anti-Trust Suit." In such return the petitioner deducted the attorneys' fees of $151,971.

In the notice of deficiency the respondent did not disallow the claimed deduction for attorneys' fees. However, he held:

> * * * that the full amount of $478,142.00, received by the corporation in 1951 in settlement of an antitrust suit constitutes ordinary income in full to it for the year 1951 under the provisions of Section 22 of the Internal Revenue Code of 1939. Accordingly, it

is held that in addition to that part of the settlement proceeds, or $159,380.00, which the corporation included in its taxable income for 1951, there also should be included in its 1951 taxable ordinary income the remainder of the settlement proceeds, or $318,762.00, which the corporation reported in Schedule M of its 1951 Federal income tax return as being "Other nontaxable income: Punitive Damages Awarded in Federal District Court for Anti-Trust Suit", and excluded from its taxable income for the year 1951.

OPINION.

Of the amount of $478,142 received by the petitioner in the settlement of the antitrust suit, $132,000 was paid specifically as reimbursement for attorneys' fees. The parties are in agreement that to that extent the recovery constituted ordinary income and that such amount is deductible by the petitioner. The controversy relates to the remainder of the award, $346,142.

In its return for 1951 the petitioner reported one-third of $478,142, or $159,380, as ordinary income. It reported the balance, $318,762, as nontaxable income with the explanation that it represented punitive damages awarded in the antitrust suit. Thereafter, in *Commissioner* v. *Glenshaw Glass Co.*, 348 U. S. 426, the Supreme Court held that the punitive two-thirds portion of a treble-damage antitrust recovery constitutes taxable income under section 22(a) of the Internal Revenue Code of 1939.

The present position of the petitioner is that no portion of the amount received in settlement constituted punitive damages and that the whole amount, aside from the attorneys' fees, should be regarded as a nontaxable return of capital. It argues that the gravamen of its action in the antitrust suit was the injury and damage to its business generally by the tortious tactics and actions of the defendants, that it was specifically alleged in the com-

plaint that a portion of its business, namely, the goggles business, was destroyed, and that hence the capital invested in that business and the goodwill attaching thereto were injured and destroyed. It is contended, therefore, that the amount received should be regarded as payment in reduction of a loss of capital rather than as taxable income. The petitioner relies principally upon *Farmers & Merchants Bank of Catlettsburg, Ky.* v. *Commissioner* (C. A. 6) 59 F. 2d 915, reversing 20 B. T. A. 622.

The respondent, on the other hand, determined that the full amount of the award constituted ordinary income under section 22(a). On brief he argues principally that the amount received, aside from that received for attorneys' fees, was compensation for lost profits.

The taxability of the proceeds of a lawsuit, or of a sum received in settlement thereof, depends upon the nature of the claim and the actual basis of recovery. If the recovery represents damages for lost profits, it is taxable as ordinary income. However, if it represents a replacement of capital destroyed or injured, the money received, to the extent it does not exceed the basis, is a return of capital and not taxable. *United States* v. *Safety Car Heating & Lighting Company*, 297 U. S. 88; *Phoenix Coal Company, Inc.*, v. *Commissioner* (C.A. 2), 231 F. 2d 420; *Durkee* v. *Commissioner*, (C. A. 6) 162 F. 2d 184; *Raytheon Production Corporation* v. *Commissioner* (C. A. 1), 144 F. 2d 110, certiorari denied 323 U. S. 779; *Swastika Oil & Gas Co.* v. *Commissioner* (C. A. 6), 123 F. 2d 382, certiorari denied 317 U. S. 639; *Arcadia Refining Co.* v. *Commissioner* (C. A. 5), 118 F. 2d 1010; *Liebes & Co.* v. *Commissioner* (C. A. 9), 90 F. 2d 932; *Estate of Mable K. Carter*, 35 T. C. 326, on appeal (C. A. 8); *Ralph Freeman*, 33 T. C. 323; *Chalmers Cullins*, 24 T. C. 322; and *Telefilm, Inc.*, 21 T. C. 688.

The respondent's determination that the amount in controversy is taxable as ordinary income is presumptively

correct, and the burden of proof was upon the petitioner to show what portion of the amount received, if any, constituted nontaxable income. *Welch* v. *Helvering*, 290 U. S. 111; *Phoenix Coal Co.* v. *Commissioner, supra; Liebes & Co.* v. *Commissioner, supra; Durkee* v. *Commissioner, supra; Ralph Freeman, supra;* and *Chalmers Cullins, supra.*

In the instant case the antitrust suit was tried and damages awarded, but the court granted a motion for a new trial and the case was settled out of court by the parties. The general release which the petitioner signed specifically designates $132,000 of the lump sum of $478,142 as reimbursement of attorneys' fees. Therein the parties did not specify to what extent, if any, the balance of $346,142 might be allocable to recovery of lost profits, to compensation for injury to capital, or to punitive damages. However, reference was made therein to the fact that such balance was the amount of damages which, upon the trial, the plaintiff had claimed for the period January 1, 1936 through December 31, 1943. This amount was the amount which, at the antitrust trial, the petitioner's president, Sager, testified represented the estimated lost net profits from the goggles business over that period. This indicates strongly to us that the amount of $346,142 received in settlement represented compensation for lost profits. We note also that in filing its return for the year 1951, the petitioner made no claim that any portion represented a reimbursement for loss of capital.

The petitioner on brief makes much of the fact that the complaint in the antitrust suit alleged that there had been damage to its business and property generally through injury or destruction of the goggles business, and the fact that in his charge to the jury the District Court judge stated that the allegation had to do with damage to the petitioner's business or property and that the jury should award damages if it found that the petitioner was ex-

cluded from the goggles business. However, as we read the instructions to the jury they are of a general nature and could well contemplate a finding of damages for lost profits. The complaint itself specifically alleges damage for lost profits, in addition to the general allegation of damage to the business and property. In this respect the instant case is distinguishable from the case principally relied upon by the petitioner, *Farmers & Merchants Bank of Catlettsburg, Ky.* v. *Commissioner*, *supra*, and from *Durkee* v. *Commissioner*, *supra*. In those cases the taxpayer did not seek reparation for loss of profits, but only for tortious injury to goodwill. In each of those cases, the allegation as to profits before and after the acts complained of was merely an evidential factor in determining actual loss and not an independent basis for recovery.

On brief the petitioner also contends that the testimony of Sager in the instant case is a basis for holding that the recovery to the extent of $346,142 constituted an amount received in reduction of loss of capital rather than ordinary income. Sager testified that the petitioner lost goodwill and patronage of customers in the goggles business, and he estimated the value thereof at $500,000. He also testified that the petitioner had invested an estimated amount of $50,000, including a part of his salary and a part of the salaries of others, in research, equipment, and advertising in the goggles business. He stated that in his opinion the amount received in settlement was not sufficient to compensate the petitioner for the injury and damage to its business and property. But irrespective of whether the petitioner did in fact sustain some damage to its goodwill or to other capital assets, the ultimate question to be determined here is whether the amount paid in settlement was, to any extent, for such damage. Sager himself testified that he did not participate in the settlement negotiations and the persons who did engage in such settlement did not testify. As above, the release itself

does not indicate that any portion of the amount agreed upon was compensation for damage to capital.

Upon a consideration of the record as a whole, we cannot conclude that the petitioner has met its burden of showing that any portion of the amount received in settlement was paid as compensation for injury to goodwill or any other capital item. Neither the complaint, nor the release, nor the evidence as a whole provides a basis for making an allocation of the recovery and finding that all or any part represented a return of capital.[2] See *Liebes & Co. v. Commissioner, supra; Ralph Freeman, supra;* and *Chalmers Cullins, supra.*

We hold that the respondent did not err in treating the full amount received by the petitioner in settlement as ordinary income.

Decision will be entered under Rule 50.

[2] In this respect it should also be noted that although Sager testified that the goodwill and patronage of the goggle business which was lost had an estimated value of $500,000, there is no evidence whatever as to the cost or other basis thereof. Thus, even if some portion of the settlement was for damage to capital, such amount would constitute income. It should also be noted that although Sager testified that the estimated amount, including a part of his salary and a part of the salaries of others, which the petitioner had invested in equipment and for research and advertising was $50,000, and that this investment had been lost, there is no evidence to show that whatever amount was so expended, or a part thereof, had not been deducted by the petitioner. If so, any recovery thereof would constitute taxable income.

TAX COURT OF THE UNITED STATES.

* * * (Caption—75057) * * *

DECISION.

Pursuant to the opinion of the Court filed September 29, 1961, and the agreed computation of the tax liabilities filed by the parties, and incorporating herein the facts recited in the computation as the findings of the Court, it is

ORDERED and DECIDED: That there is a deficiency in income tax due from the petitioner for the taxable year 1951 in the amount of $164,060.10.

Craig S. Atkins,
Judge.

Entered: Dec. 21, 1961.

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the agreed computation of the parties, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein, pursuant to the statute in such cases made and provided.

Llewellyn A. Luce,
Counsel for Petitioner,

Crane C. Hauser,
Chief Counsel, Internal Revenue Service.

(Seal)